

Adopting a Long-Term Budget Focus: Challenges and Proposals

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Summary

One criticism of the current budget process is that it does not encourage or require the consideration of long-term budgetary concerns. In this context, a long-term concern is one that affects the budget beyond the traditional five- or 10-year budget window as currently used in the congressional budget resolution and the President's budget.

Some components of the budget process already deal with long-term budget issues. This means that data already exist, in publicly available formats, to assist in evaluating the country's long-term fiscal health. In some instances, data evaluating the long-term outlook of certain programs are currently available, including on those programs that are generally thought of as the most challenging to deal with going forward. Long-term components of the budget process can be separated into two general categories and are currently used for two distinct purposes: long-term budgetary data used for informational purposes and rules affecting long-term outcomes that are used for enforcement purposes.

Proponents of more formal long-term budgeting have expressed concerns that the current process allows difficult long-term decisions to be avoided, hides the long-term effects of certain budgetary decisions, and does not provide incentives or tangible goals for achieving long-term deficit reduction. To address these concerns, some have recommended modifying the budget process in various ways to incorporate a long-term budgetary outlook.

Some critics of this approach, however, suggest that information already exists to make long-term evaluations possible, so that a shift to longer-term budgeting alone would not improve the ability of Congress or the President to make the decisions necessary to achieve long-term sustainability of budget policies. Further, some have argued that there are fundamental issues that make successful longer-term budgeting impractical, such as projection uncertainty, unforeseen events, and the problem of trying to bind future Congresses to specific goals.

President Obama's Commission on Fiscal Responsibility and Reform, several outside groups, and some members of Congress have released or are expected to release budget and budget process reform proposals. Many proposals contain reform options that focus on a longer-term outlook.

Five major proposals are analyzed in this report: (1) extending the time period of the current budget window to provide greater detail about fiscal challenges ahead and the long-term effects of proposed legislation; (2) employing multi-year budget controls that would require the outyears of the President's budget proposal and the congressional budget resolution to be adhered to; (3) creating annual fiscal targets that could be used either for informational purposes or to enforce specific budgetary outcomes; (4) increasing budget transparency in various ways; and (5) switching from cash-flow accounting to accrual-basis accounting to capture the effects of future entitlements in the current budget.

Contents

Introduction	1
Horizons Used in the Current Budget Process	1
The Traditional Five- or 10-Year Budget Horizons	1
Existing Long-Term Budgeting Components.....	3
Informational Components	3
Enforcement Components.....	4
The Rationale for Long-Term Budgeting	5
Major Challenges Associated with Long-Term Budgeting	6
The Automatic Nature of Most Mandatory Spending and Revenue	6
Projection Uncertainty	7
Unforeseen Events	7
Underlying Projection Assumptions.....	7
Binding Future Congresses or the President to Congress’s Goals	8
Analysis of Long-Term Budgeting Proposals	8
Extend the Current Budget Window	9
Adopt Multi-Year Budget Plans	9
Create Deficit or Debt Targets.....	10
Switch from Cash-Flow Accounting to Accrual-Basis Accounting	15
Increase the Transparency of Budgetary Decisions	17

Contacts

Author Information.....	18
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Introduction

Both the President and Congress play a role in forming federal spending and revenue policy: the President submits an annual budget proposal, and Congress typically adopts an annual budget resolution and then passes legislation, which must be signed by the President, within the parameters established by that budget resolution.¹

These budgetary decisions, about overall federal spending and revenue, are currently made on an annual basis, and it has been argued that the process does not require or encourage the consideration of long-term concerns. Further, it has been argued that no uniform long-term goals exist for both the President and Congress to work toward when designing their respective annual proposals.

Many groups and individuals, both inside and outside government, have been issuing recommendations to put the budget on a fiscal track that is sustainable over the long term. The budget is considered to be on a sustainable path if the resulting debt-to-GDP ratio is constant or falling. Some of these groups assert that to successfully make changes in spending and revenue policy, changes must be made to the budget process. They argue that the short-term focus of the current budget process has a dire effect on the long-term budget for several reasons: it allows difficult long-term decisions to be avoided; it hides the long-term effects of certain budgetary decisions; and it does not provide incentives or tangible goals for achieving long-term deficit reduction. To address these concerns, some have recommended modifying the budget process in various ways to focus on the long-term budgetary outlook.

This report will provide information on (1) the current horizons used in the budget process, including already existing long-term components; (2) the rationale for increased focus on long-term budgeting; (3) general challenges to long-term budgeting; and (4) an analysis of general proposals that have been made to increase the focus of long-term budgeting in the budget process. This report will not discuss general budget process reform proposals except those related to long-term budgeting, nor will it address policy proposals to reduce spending or increase revenues in the long run.² This report defines long-term budget process proposals to be those that affect the budget beyond the traditional five- or 10-year budget window.

Horizons Used in the Current Budget Process

The Traditional Five- or 10-Year Budget Horizons

With some exceptions, the budget window, as currently used in the federal budget process, typically spans either a five- or 10-year period. The purpose of the budget window and baseline projections is to evaluate how proposed legislation affects the current budget outlook and to measure whether legislation adheres to rules established by the House and Senate. The use of the 10-year budget window also balances the importance of considering both the current and future implications of budgetary decisions within the limits of constructing accurate and timely budget

¹ For more information on the budget process, see CRS Report 98-721, *Introduction to the Federal Budget Process*, coordinated by Bill Heniff Jr.

² For more information on the long-term budget outlook and policy options, see CRS Report RL32747, *The Economic Implications of the Long-Term Federal Budget Outlook*, by Marc Labonte. For more information on budget reform, see CRS Report R40113, *Federal Budget Process Reform in the 111th Congress: A Brief Overview*, by Megan Suzanne Lynch.

projections. Programs that may be manageable within the 10-year window may become unmanageable over a longer period, however.³

The annual baseline projection provided by the Congressional Budget Office (CBO) to assist Congress in decision making and budget enforcement spans 10 years. The CBO baseline projects federal spending and receipts under existing law as a benchmark for informational purposes, and for evaluating proposed budgetary changes in spending or revenue.⁴ The CBO baseline has spanned a 10-year period since 1996; previously it spanned five years. The baseline is used by Congress as a starting point to construct the budget resolution.

The annual budget resolution, an agreement between the House and Senate used as an enforceable framework for annual budgetary decisions, requires a budget window of five years.⁵ However, this requirement, from the Congressional Budget Act of 1974 (The Budget Act), is a minimum, and budget resolutions have occasionally spanned longer periods of time of up to 10 years.⁶ In some fiscal years, when Congress does not reach an agreement on a budget resolution, spending and revenue decisions are not explicitly laid out.

In February of each year when the President submits his annual budget request encompassing his proposed policy changes, information is provided for a 10-year window. The Office of Management and Budget (OMB) prepares budget baselines that are included in the President's budget to illustrate the budgetary impact of his proposals. All of OMB's budget projections, the current law baseline, the current policy baseline, and the proposed policy projection, currently span a 10-year period.⁷

Within their respective budget proposals, both Congress and the President present budget goals they would like to achieve over the next five or 10 years. But since budget plans are revised annually, as a practical matter, the current budget process largely approaches spending and revenue decisions on an annual basis. The lack of a long-term focus in the budget process does not force action on already existing and well-known long-term fiscal issues.

CBO and the Joint Committee on Taxation (JCT) prepare spending and revenue estimates showing the budgetary impact of individual legislation to assist Congress in weighing the merits of a bill and for budget enforcement purposes. The Congressional Budget Act of 1974 requires that estimates apply to a five-year period, to ensure the measure's compliance with the budget resolution.⁸ Estimates, however, frequently span other time periods to assist with enforcement of other budgetary rules.

³ OMB, *Budget for Fiscal Year 2011, Analytical Perspectives*, p. 45.

⁴ Requirements for CBO's baseline can be found in Section 257 of the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177). The baseline is released by CBO in *The Economic and Budget Outlook* near the beginning of the calendar year and is updated once a year before the end of the same fiscal year.

⁵ Specifically, section 301(a) of the Congressional Budget Act of 1974 (P.L. 93-344) (The Budget Act) states that the concurrent resolution shall set forth appropriate levels for the fiscal year beginning on October 1 of such year and at least four ensuing fiscal years for the following—(1) totals of new budget authority and outlays; (2) total federal revenues and the amount, if any, by which the aggregate level of federal revenues should be increased or decreased by bills and resolutions to be reported by the appropriate committees; (3) the surplus or deficit in the budget; (4) new budget authority and outlays for each major functional category, based on allocations of the total levels set forth pursuant to paragraph (1); and (5) the public debt; etc.

⁶ For more information on budget resolutions, see CRS Report 98-815, *Budget Resolution Enforcement*, by Bill Heniff Jr. and CRS Report 98-512, *Formulation and Content of the Budget Resolution*, by Bill Heniff Jr.

⁷ The current policy baseline was first used in President Obama's FY2010 budget.

⁸ Section 402(1) of The Budget Act.

The House and Senate each have PAYGO rules with the parallel goal of ensuring deficit neutrality of any new direct spending or revenue legislation, based on the CBO or JCT score of the legislation.⁹ The House and Senate PAYGO rules cover a six-year and an 11-year period. To enforce PAYGO rules, a member must raise a point of order, which can be waived by a majority vote in the House or a three-fifths vote in the Senate. As with all House rules, the PAYGO rule in the House must be re-adopted in each new Congress; the Senate PAYGO rule is currently set to expire in 2017.

Additionally, there is a statutory PAYGO requirement that applies to both a five-year and a 10-year period.¹⁰ Statutory PAYGO, as enacted in February 2010, seeks to enforce deficit neutrality on the net impact of new revenue and mandatory (direct) spending provisions by recording their budgetary effects on two scorecards maintained by OMB covering rolling five- and 10-year periods. After the conclusion of a congressional session, if a debit has been recorded for the budget year on either scorecard the President issues a sequestration order that implements across-the-board cuts in non-exempt direct spending programs by an amount sufficient to rectify the debit on the PAYGO scorecard. Amending statutory PAYGO would require the enactment of new legislation. Generally, House and Senate PAYGO rules seek to enforce deficit neutrality on individual legislation; statutory PAYGO seeks to enforce deficit neutrality on overall mandatory spending and revenue legislation enacted over the entire session.

Existing Long-Term Budgeting Components

Some components of the budget process already deal with long-term budget issues. This means that data already exist, in publicly available formats, to assist in evaluating the country's long-term fiscal health. In some instances, data evaluating the long-term outlook of certain programs are currently available, including on those programs which are generally thought of as the most challenging to deal with going forward. Long-term components of the budget process can be separated into two general categories and are currently used for two distinct purposes: long-term budgetary data used for informational purposes and rules affecting long-term outcomes that are used for enforcement purposes.

Informational Components

Generally, long-term informational components are used, not to enforce specific outcomes, but to provide budgetary information to assist with congressional decision making. Several government publications already provide long-term budget projections and options for reducing the budget deficit to a sustainable level. However, only OMB's long-term projections are included in the primary budget documents, and OMB's projections are presented in a different volume from the main proposal.

Since 1996, the CBO has periodically published *The Long-Term Budget Outlook*, which "presents illustrative scenarios for federal spending and revenues and describes the implications of those scenarios for the economy."¹¹ One goal of the report is to provide information on the long-term budgetary pressures associated with the aging of the baby-boom generation and the continued growth in healthcare costs. The current report mainly focuses on projections out to 2035, with

⁹ For more information, see CRS Report RL32835, *PAYGO Rules for Budget Enforcement in the House and Senate*, by Robert Keith and Bill Heniff Jr.

¹⁰ The Statutory Pay-As-You-Go Act of 2010 (P.L. 111-139). For more information on Statutory PAYGO, see CRS Report R41157, *The Statutory Pay-As-You-Go Act of 2010: Summary and Legislative History*, by Bill Heniff Jr.

¹¹ CBO's most recently published Long-Term Budget Outlook can be found at <http://www.cbo.gov/doc.cfm?index=11579>.

additional data to 2084 available in the “Data Underlying Scenarios and Figures” posted on the CBO website. Projections of revenue, spending, and federal debt are made under several different scenarios because of the uncertainty related to budgetary and economic assumptions. The report also presents estimates of the “fiscal gap,” which is the amount that spending must be permanently cut or revenues must be permanently raised to stabilize the debt as a share of GDP over the long run.

Similarly, the “Long Term Budget Outlook” chapter of the *Analytical Perspectives* volume of the President’s Budget includes 75-year projections for current programs. These projections are based on a variety of variables, including long-range cost projections from the Centers for Medicare and Medicaid Services. This section also incorporates demographic and economic assumptions and illustrates alternative spending, revenue, and growth scenarios. The Government Accountability Office (GAO) also produces a similar report on the long-term budget outlook using their own models and simulations.¹² CBO, OMB, and GAO all agree that the budget is on an unsustainable path, largely driven by the projected long-term growth in Medicare, Medicaid, and Social Security, which is not matched by projected growth in revenues.

Social Security and Medicare Trustees issue respective actuarial estimates of each trust fund for the upcoming 75-year period.¹³ These reports contain both short- and long-range projections of annual program expenditures and payroll tax receipts. There are also estimates of the actuarial deficits over the next 75 years that measure the solvency of the trust funds relative to dedicated revenues. These deficits represent the shortfall between the program’s projected expenditures and income. The Trustees’ reports do not address how these programs affect the sustainability of the overall budget.

Finally, another comprehensive look at the financial outlook is contained in the Department of the Treasury report *Financial Report of the United States Government*.¹⁴ This report uses accrual-based accounting methods to present a balance sheet for the federal government. It includes certain liabilities of the government on a net present value basis, including federal employee and veteran benefits, and federal insurance and loan guarantee liabilities. This report does not treat the future projected shortfalls of Social Security and Medicare to be official liabilities of the government, but provides estimates of the long-term actuarial deficits of the programs nevertheless.

Enforcement Components

The long-term reports discussed in the previous section do not play a role in current enforcement mechanisms. Most existing enforcement mechanisms, like PAYGO or the levels in the budget resolution, apply to shorter budget windows, with some exceptions.

In the Senate, it is not in order to consider a reconciliation measure that would increase the deficit or reduce the surplus outside the budget window provided in the budget resolution.¹⁵ In addition, it is not in order to consider a measure that would cause a net increase in the deficit in excess of

¹² GAO, The Federal Government’s Long-Term Fiscal Outlook, most recent from November 2010, available at <http://www.gao.gov/new.items/d11201sp.pdf>.

¹³ The most recent report from the Social Security Trustees can be found at <http://socialsecurity.gov/OACT/TR/2010/tr2010.pdf>. The most recent report from the Medicare Trustees can be found at <https://www.cms.gov/ReportsTrustFunds/downloads/tr2010.pdf>.

¹⁴ The FY2009 report is available at <http://www.fms.treas.gov/fr/09frusg/09frusg.pdf>. The FY2010 report is scheduled for release in December 2010.

¹⁵ This exists as part of the “Byrd Rule,” Section 313(b) of The Budget Act.

\$5 billion in any of the four 10-year periods beginning in 2019 through 2058.¹⁶ Both of these rules can be waived by a three-fifths vote of all Senators duly chosen and sworn.

In the House, it is not in order to consider legislation that would provide for a net increase in Social Security benefits or decrease in Social Security taxes in excess of 0.02% of the present value of future taxable payroll for a 75-year period, or in excess of \$250 million for the first five-year period after it becomes effective.¹⁷ In addition, it is not in order in the House to consider legislation that would cause a net increase in mandatory spending in excess of \$5 billion in any of the four consecutive 10-year periods following the budget window included in the latest congressional budget resolution.¹⁸ These points of order can be waived by a simple majority.¹⁹

The Rationale for Long-Term Budgeting

Large budget deficits have persisted over the past several fiscal years. Federal debt held by the public as a percentage of gross domestic product (GDP) has risen from 36% in 2007, prior to the current economic downturn, to roughly 62% as of the end of 2010.²⁰ Deficits at current levels are considered unsustainable because they are large enough to cause the debt to continually rise relative to GDP, and are projected to grow larger beyond the 10-year budget window. Under one set of policy assumptions, debt held by the public as a percentage of GDP is projected to rise to nearly 90% by 2020 and 185% by 2035.²¹ If this were to actually occur, the accumulating debt would lead to significant growth in net interest payments, crowding out of other types of investment, reduced national savings, increased interest rates, a reduction in the flexibility of policymakers to handle unexpected challenges, and an increased likelihood of a fiscal crisis.

The short-term focus of the current process arguably obscures the long-term effects of the growth of certain programs, and it does not highlight potentially difficult long-term tradeoffs. Further, it does not provide incentives or tangible goals for achieving long-term deficit reduction. Since delay increases the size of the fiscal imbalance, critics argue that this exacerbates a long-term outlook that is already unsustainable, and that it is easier to solve long-term problems ahead of time than if decisions are postponed. Making changes earlier allows changes to be phased in more gradually and allows those that cannot adjust to changes to be exempted. For example, if policymakers decided to reduce entitlement benefits for the elderly, a longer phase-in period would make it easier to exempt from the changes those who are already retired (and cannot earn or save more to compensate).

The 10-year window for scoring legislation, and its interaction with existing enforcement mechanisms, provides an incentive to make legislation less costly within the 10-year window than outside of it. This encourages the use of phased-in provisions or provisions that reduce the deficit in the short run but increase the deficit in the long run. For example, the creation of Roth Individual Retirement Accounts (IRAs) as an alternative to traditional IRAs raises revenues in the

¹⁶ This was included in section 311(b) of the budget resolution for FY2009: S.Con.Res. 70 (110th Congress). This is scheduled to expire on September 30, 2017.

¹⁷ Section 13302(a) Budget Enforcement Act of 1990 (P.L. 101-508).

¹⁸ As specified in H.Res. 5 (112th Congress) Separate orders (g) Limitation on Long-term Spending.

¹⁹ Separate from official scores, CBO has provided detailed long-term cost estimates of certain Social Security reform and healthcare legislation in the past.

²⁰ Unless otherwise noted, years in this report refer to the federal fiscal year. References to debt are to debt held by the public, not gross debt.

²¹ Congressional Budget Office, *The Long-Term Budget Outlook*, June 2010, Table1-2, available at <http://www.cbo.gov/doc.cfm?index=11579>.

short run, because taxes on Roth IRAs are paid at the time of contribution, but loses revenues in the long run, when accumulated growth is exempt from tax.

An alternative perspective on long-term budgeting posits that the nation's long-term fiscal problems are already well understood, potential solutions are already well chronicled, and the specific problems are unrelated to the long-term budget information. Nor has deficit reduction been ignored in the current budget—for example, a central goal in the President's budget proposal for the past two fiscal years has been to reduce the deficit over the budget window, and the Administration has made specific proposals on how to achieve that goal—although it has not yet been accomplished. A case can be made that the main problem with tackling fiscal sustainability is that current policy for revenue and mandatory spending (which comprises approximately three-fifths of total spending) is automatic and will continue at levels inconsistent with sustainability. A shift to long-term budgeting alone would not change this fact. From this perspective, changes in the budget process are secondary to the problem of arriving at consensus on the changes to revenues or spending necessary to provide sustainability. That is, budget process reform can not be a substitute for the tough decisions required on long-term spending and revenue policy in order to reach fiscal sustainability.

Furthermore, since the current fiscal year's deficit is already large, addressing the budget deficit “problem” does not require detailed knowledge of the long-term budget outlook, nor does it require incorporation of the long-term budget into the budget process. Since the current five- to 10-year budget windows used for planning and enforcement mechanisms have been unsuccessful in reducing budget deficits over the next five to 10 years to sustainable levels, would a longer budget window be successful in solving long-term fiscal issues? Some feel that while many types of budget process reform could be useful, “the process is not the problem. The problem is the problem.”²²

Major Challenges Associated with Long-Term Budgeting

If Congress were to adopt a budget process with an increased long-term focus, there are several challenges to address when shaping changes. These include addressing the automatic nature of most mandatory spending and revenue, projection uncertainty, unforeseen events, underlying projection assumptions, and the problem of trying to bind future Congresses or the President to Congress's current goals. In addition, determining how to integrate information for purposes of enforcing budgetary goals may be difficult.

The Automatic Nature of Most Mandatory Spending and Revenue

Mandatory spending currently makes up about three-fifths of total federal spending. Most of it is automatic, that is, it does not require congressional action to continue in the current form. Examples of mandatory programs include Medicare and Medicaid, where benefits are paid out if an individual meets the eligibility criteria, and interest paid on the federal debt. Further, these programs are the ones that are forecast to grow most rapidly in the long run. Because spending on these programs occurs unless new legislation changes the benefit structure or eligibility criteria, changes to the budget process to incorporate long-term decisions are unlikely to restore

²² Although this quote is widely used when discussing various types of budget process reform, it is typically attributed to former CBO Director Rudolph G. Penner. The first found reference is Elizabeth Wehr, “Congress Likely to Resist Budget Process Change,” *Congressional Quarterly Weekly Report*, December 27, 1986, p. 3142.

sustainability unless they incorporate a way to deal with the “autopilot” spending that occurs under these programs. Likewise, most components of the tax code are permanent, and there is no mechanism in place to require Congress to adjust them if current revenue levels are inconsistent with long-term goals. Some major provisions do have sunset provisions, but depending on these opportunities alone could lead to any needed revenue adjustments being concentrated in only those parts of the tax code that require extension.

Of course, the fact that most mandatory spending and revenue laws are permanent could be seen as a form of long-term budgeting. But in the context of the current long-term fiscal imbalance, the problem with the permanent nature of these programs is that because the formulas that determine spending and revenue are fixed, so is the imbalance.

Projection Uncertainty

Using long-term projections as a base for budgetary decisions can be problematic. Projections of any type contain a degree of uncertainty. The further out a projection is relative to when it is made, the more inaccurate it tends to be. Budget baseline estimates and projections are highly sensitive to small changes in underlying assumptions and economic factors, and changes to these assumptions grow in importance as the forecast is extended. Economic forecasts remain subject to substantial margins of error, even over short periods of time. Although cyclical factors even out over time, small errors in underlying structural factors can compound to cause large differences in long-term totals. Making programmatic changes to achieve fiscal goals based on these projections may result in changes that ultimately over- or under-shoot what is needed. For example, based on past forecast errors, CBO has estimated that there is a 50% chance that the budget deficit will be 0.5 percentage points of GDP higher or lower than their January projection for the current year, and 2.2 percentage points of GDP higher or lower for five years in the future.²³

Unforeseen Events

Most of the legislative spending increases relative to the baseline that occurred in the past decade were due to unforeseen events, including the terrorist attacks of September 11, 2001, military outlays in Afghanistan and Iraq, Hurricane Katrina and other natural disasters, and the 2008 financial crisis. Spending has increased significantly over the past several fiscal years due to the economic downturn and resulting legislation. At the same time, revenues have also declined, resulting in large budget deficits. Unexpected shocks like these, which led to the large increases in spending and declines in revenues, are unpredictable and would be difficult to account for in a long-term budget process. Over long periods of time, events are even harder to predict—75 years ago, the nation was in the midst of the Great Depression, had not yet fought World War II, and major federal programs such as Medicare and Medicaid did not exist. Inserting flexible mechanisms to deal with uncertain situations and “emergencies” as they occur may be necessary, but risk compromising the ability to achieve the overall goals of a long-term budget process.

Underlying Projection Assumptions

Budget projections are based on simple rules of thumb, where more sophisticated projections are impractical. In long-term budget projections, these rules of thumb include assuming discretionary spending remains constant as a share of GDP, revenues stay constant as a share of GDP (in some projections), and that health spending will initially grow faster than GDP based on historical rates, but gradually grow no faster than GDP. Small changes to these rules of thumb lead to large

²³ CBO, *The Uncertainty of Budget Projections: A Discussion of Data and Methods*, March 2007, Table 6.

differences in outcomes over 75 years. For example, CBO projects that federal spending on healthcare will rise from 5.5% of GDP in 2010 to 10.9% of GDP in 2035. But if healthcare spending grows more closely to historical rates, federal healthcare spending would be 11.5% of GDP in 2035, and if healthcare spending grows at the same rates as GDP, federal healthcare spending would be 8.7% of GDP in 2035.

Another challenge posed by incorporating long-term projections into official projections is that current rules of thumb in the official baseline are different than those used in long-term projections. This is because simple extrapolations of the 10-year baseline would lead to results that bear no relationship to current policy over 75 years. In the official 10-year baseline, these rules of thumb include adjusting discretionary spending for inflation, and allowing tax provisions to expire as scheduled, including the 2001 to 2003 tax cuts (popularly referred to as “Bush tax cuts”) and the inflation adjustment to the alternative minimum tax (AMT). If those rules of thumb were used over 75 years, discretionary spending would fall to a share of GDP much smaller than historical levels and most taxpayers would fall under the AMT by the end of the projection period.

Binding Future Congresses or the President to Congress’s Goals

Another challenge to long-term budgeting is the difficulty of the current Congress to bind future Congresses to its plans. Congress may set detailed plans for changes to be made to future spending programs and the tax code that restore solvency, but even if these changes are enacted into law, future Congresses would be free to change them.

There is also no guarantee that Congress and the President will agree on overall goals, or specific ways to meet them, either now or in the future. Without uniform annual or long-term objectives in the budget process, both the President and Congress lack shared goals to work towards when designing the President’s budget proposal or the congressional budget resolution. If the President and Congress disagree on goals, each side may lack the incentive to take steps necessary to meet their respective goals.

Analysis of Long-Term Budgeting Proposals

Congressional interest in budget reform has grown in light of current and forecast budget deficits as well as increasing public concern over the long-term budget outlook. President Obama’s National Commission on Fiscal Responsibility and Reform, several outside groups, and some members of Congress have released or are expected to release proposals with the goal of returning the federal budget to a more sustainable course. Some proposals contain options to reform the budget process with an emphasis on changing the budgetary focus to a more long-term outlook. To implement a viable long-term budget process, it would be important to incorporate both information and enforcement mechanisms into changes to budget procedure.

As discussed above, the current budget process has been criticized on three grounds in relation to the current budget window. It allows difficult long-term decisions to be avoided, it hides the long-term effects of certain budgetary decisions, and it does not provide incentives or tangible goals for achieving long-term deficit reduction. The following sections evaluate proposals that attempt to address these issues. Those proposals include extending the current budget window, adopting a multi-year budget process, creating statutory deficit targets, switching from cash-flow accounting to accrual-basis accounting, and increasing the transparency of budget decisions. In many cases, these proposals have been discussed in general terms with limited detail.

Extend the Current Budget Window

Certain proposals recommend extending the current five- or 10-year budget window, to encompass a greater period of time, such as 20 years. It has been asserted that this will not only provide greater detail about the fiscal challenges that lie ahead but also provide information on the effects that proposed legislation may have beyond the five- or 10-year budget period. As discussed earlier, the current budget window essentially ignores the effects of spending and revenue provisions on the fiscal outlook. This means that neither the impact of new legislation nor the performance of current programs beyond the 10-year period is generally available for consideration during votes.²⁴ Further, programs like Social Security, whose finances are not necessarily out of balance in the short run, have well-discussed long-term imbalances. Currently, budget enforcement mechanisms, like statutory PAYGO, examine the effects of new provisions on the baseline over the next five or 10 years and evaluate whether or not they meet specific goals over that period.

To improve the long-term fiscal outlook, it may be necessary to know how new legislation or programmatic changes, reforms, or modifications affect the budget beyond the current decade. This would require budget projections to extend into a second decade or beyond. Because there is a significant degree of uncertainty associated with projections, especially beyond the first 10 years, proposing to extend the budget window should proceed with some caution. Further, even if the budget window were to be extended to 20 or 30 years, it may still be possible to hide the costs of certain obligations or the long-term costs of certain programs even beyond that period of time.

Incorporating projections beyond 10 years into the budget process could be useful for informational purposes, which may not necessarily be tied to enforcement. OMB, CBO, and Treasury already produce information out 75 years that could be used in an extended budget window. CBO could also include this information in their cost estimates of legislation.

Adopt Multi-Year Budget Plans

Budget reform advocates often include proposals for a multi-year budget plan that they assert would help reach long-term budgetary goals. The annual budget resolution already requires a budget window containing spending, revenue, and deficit levels for the upcoming fiscal year and the following four years. Similarly, the President already submits a budget proposal that covers multiple years. These budgets, however, are resubmitted annually with multi-year information revised each year. For instance, a budget resolution for FY2011 may include a spending level for FY2012, but the following year when the budget resolution for FY2012 is drafted, it need not adhere to the FY2012 levels set in the prior year's budget resolution. So while each budget includes outyears, those levels can be altered from year to year.

In contrast to current practice, proposals for multi-year budget plans would require that budget levels remain consistent from year to year. It has been proposed that this be achieved by creating a multi-year budget process. (It has also been suggested that this be achieved by setting deficit or debt targets each year, as discussed in the next section.) According to a generic multi-year budget plan, the President would submit a multi-year budget proposal every two or more years and Congress would no longer adopt a budget resolution annually but instead adopt a budget resolution every few years. Under some proposals, appropriation bills could also cover multiple

²⁴ CBO has provided long-term estimates of the effects in the scores of certain Social Security and healthcare reform legislation in the past.

years. By doing this, it is argued that Congress would agree upon future year limits and be forced to adhere to them.

Traditionally, advocates for biennial or multi-year budgeting assert that it would lighten the congressional workload because Congress would no longer need to make budgetary decisions annually, allowing more time to focus on other matters, such as executive branch oversight and budgetary planning. This argument was particularly prevalent in years when the budget resolution was not agreed to or was agreed to later than expected. More recently, multi-year budgeting has been viewed as a tool for setting and adhering to medium and long-term deficit goals.

Some critics feel that it is unrealistic to expect one Congress to agree to adhere to a budget set by a previous Congress, given that policy priorities change and unexpected contingencies arise. This applies not just to an overall budgetary goal, but also to individual components of the budget.

Multi-year budgets could also reduce the effectiveness of program implementation. Under the current annual budget process, a significant period of time already elapses between when agencies request funding for specific activities, and when Congress actually considers such legislation. For example, work on the President's FY2012 budget began in the summer of 2010 as agencies began to develop their budget requests. Under proposed plans for multi-year budgeting, the budget resolution would give committees their allocations for the next few years and would require the executive agencies to assess their future needs even further in advance.

Further, binding a Congress to previously agreed-to totals could result in avoidance and accounting gimmickry. For example, if a multi-year budget allowed emergency spending above the planned total, there would be incentive to classify any proposal as emergency to avoid budget caps. Reducing the frequency of aggregate budget decisions, as would occur under multi-year budgeting, may "raise the stakes" during decision making and may increase the likelihood of contention and delay—the opposite outcome of one traditional rationale for multi-year budgeting.

One logistical issue to note with multi-year budgeting is that all rules in the House, including a budget resolution, must be re-affirmed as the House reconstitutes itself at the beginning of a new Congress. This would mean that a budget resolution agreed to in the prior Congress would have to be agreed to again by the new House. If a future House of Representatives did not agree with the budgetary goals set by the previous, there is no way to compel their adherence. This makes it difficult to switch to more than a biennial budget process.

Create Deficit or Debt Targets

Many long-term budget reform proposals include budget deficit or debt targets that would reach into the long term. This would require Congress and the President to submit budget proposals that adhere to those targets. In designing a target, there are several features to consider.

Type of Target

Perhaps the first question is whether targets should be set in dollar terms or as a percentage of GDP. Economically, GDP targets are more meaningful because a larger economy is less affected by any given dollar amount of debt. Further, if the target covers an extended period of time, projection error is more of a problem for a dollar target than a GDP target. For example, lower than expected inflation over an extended period of time would make a dollar target more onerous in real terms, and vice versa. Procedurally, the current budget system revolves around dollar totals, so a GDP target might add complexity to the current process. Another disadvantage to GDP targets is that data are frequently revised and available with a lag. The plan would need to take into account that a target that is met before a data revision could turn out to be missed after the

revision. A hybrid system, where long-term goals are expressed as a percentage of GDP, but totals for the current year are converted into dollars each year, might address some of these issues.

Second, should the target be set in terms of the publicly held debt or the unified budget deficit?²⁵ In a broad sense, the distinction is not important, since deficits lead to nearly one-to-one changes in the publicly held debt. But if the plan contains only a final target, without interim targets, a debt target would require that higher than expected deficits in some years be negated by lower deficits in other years. Annual targets, in contrast, would presumably allow bygones to be bygones—a higher than expected deficit in the previous year would not change the deficit target for the current year. If debt is targeted as a share of GDP, it would also allow larger deficits relative to GDP when the economy is growing faster, for better or worse, since a larger GDP could accommodate a larger debt buildup along the way to the target.

Third, should targets be agreed upon by both Congress and the Administration, perhaps through the enactment of legislation? Enacting statutory fiscal goals to guide these budgetary decisions may create a national coherence in budgetary decision making that would lead to a more forward-looking long-term budget outlook. Further, it would emphasize the expectation that both the President and Congress are working toward a long-term solution to address the expected growth in the national debt. Under such a proposal, Congress and the President could agree on just a deficit target, leaving both free in the future to advocate different ways to reach that target, or they could agree on more detailed spending and revenue proposals to meet that target up front. A drawback of this approach is that if Congress and the Administration reach an impasse in setting the goals, progress toward deficit reduction could cease. If Congress worked toward deficit reduction alone, the President could only stop it through the use of the veto.

Fourth, how ambitious should the deficit or debt targets be? Some state that the targets should be modest and gradual so that they will be easier to achieve and therefore more effective over the long term. Advocates of modest targets state that more ambitious targets lead to the use of accounting gimmicks because they are otherwise impossible to meet. Additionally, it has been argued that the difficulty of reaching ambitious targets will require them to be modified later on. For instance, the deficit targets set under Gramm-Rudman-Hollings in 1985 were revised upward by the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 (1987 Reaffirmation Act). The 1987 Reaffirmation Act extended by two years the time frame set out in the 1985 act for achieving a balanced budget, requiring a balanced budget by FY1993 instead of FY1991. (In reality, the budget was not in surplus until 1998.)

Advocates of more ambitious targets claim that they are needed given the size of the fiscal imbalance. They assert that smaller, more gradual changes are a disadvantage because they require only some programs to suffer, and without shared sacrifice, any changes in spending or revenue are less politically palatable. Another argument is that overly modest goals just lead to a patchwork of smaller legislative changes and that an accumulation of this creates complicated, incoherent policy. Instead, it is argued that comprehensive changes need to be made all at once to ensure significant savings and good policy.

Finally, would Congress adopt a final target to be reached by the end of the budget window, or would there be interim targets that must be met in each year of the plan? A final target gives policymakers more flexibility to react to unforeseen contingencies and adjust the budget to take them into account. For example, in response to a natural disaster, policymakers might decide to raise the deficit that year, and then find additional savings in future years to ensure that the ultimate target is still met. On the other hand, annual targets make it more likely that the plan

²⁵ Debt targets typically exclude intergovernmental debt because it is owed from one part of the government to another and is not affected by budget deficits. Therefore, debt targets are typically for publicly held debt rather than gross debt.

“stays on track,” and policymakers do not procrastinate on changes until it is too late. That is, earlier Congresses may have little incentive to work toward a final target that applies only to later Congresses. Proposals to set statutory annual targets are discussed in more detail below.

Setting Statutory Annual Targets

A proposal to create annual deficit targets would require the President to submit a budget consistent with these goals. Additionally, when crafting a budget resolution, the House and Senate budget committees would determine the amount of savings needed to reach the annual fiscal target based on the baseline projection provided by the CBO. The budget resolution would then set aggregate spending and revenue levels consistent with the savings needed, and would make committee allocations (referred to as 302(a) allocations) that would fulfill the requirements associated with spending. The targets could be enforced by creating a point of order in the House and Senate that would disallow the floor consideration of a budget resolution that did not adhere to the prescribed deficit levels. It is unclear how an annual target would be achieved in years when Congress does not adopt a budget resolution.

Congress may also wish to consider under what circumstances the annual targets could be waived or modified. The target could be waived in specific circumstances designated ahead of time such as war or recession, or Congress could be given the discretion to waive it. Instead of mandating the use of precise deficit targets, setting a longer-term goal, with interim annual goals to be used as benchmarks to meet it, may be more flexible and easy to enforce. If, in any year, the annual goals are not reached due to incorrect economic or technical assumptions used to make projections, the next year’s annual target could be revised to keep the budget on track to meet the longer-term target. If strong economic performance accelerates the time table whereby the longer-term target could be met, the target could be revised. Setting a longer-term target with somewhat flexible intermediate goals could be more accommodating in terms of handling the effects of the business cycle. On the other hand, flexibility on interim targets could undermine the ultimate goal if it is used as a way to avoid taking unpopular steps.

Enforcement Mechanisms for Annual Deficit Targets

Statutory deficit levels, such as those described above, could exist solely for informational and guidance purposes, or they could include enforcement mechanisms, which would require that specified goals be met. Enforcement could be viewed as a spectrum of severity. At the least severe end of the spectrum, the targets could be enacted as a way of agreeing on long-term national goals. Some believe that this type of enforcement mechanism would suffice because the public’s expectations would compel the President and Congress to adhere to the set levels. On the other hand, others assert that without an explicit enforcement mechanism, levels will easily be ignored, particularly during difficult domestic periods.

In a more severe form, these targets could either be enforced through congressional points of order on the floor, or they could be enforced by a statutory mechanism, such as sequestration, which would make automatic, across-the-board cuts to non-exempt spending programs when levels are breached. The sequestration process has been used historically in the budget process in several forms.

Arguably, using only congressional points of order as enforcement mechanisms may not be adequate because points of order can be waived. In addition, future Congresses may choose to waive or modify the rules that create these points of order. Further, if adhering to the annual deficit targets would require new legislation to make changes in mandatory (direct) spending or revenue, there is no way to compel the creation of this legislation through points of order. Instead,

additional provisions would need to be included, most likely as expedited congressional procedures, that would attempt to force Congress to vote on a package of legislative changes.²⁶ However, forcing Congress to consider, and further, to agree by a certain time on the spending or revenue changes necessary to meet the targets is logistically difficult. The reconciliation process already exists to facilitate that process. The reconciliation process as established by the Budget Act facilitates the changing of existing spending, revenue, and debt-limit laws to bring them into compliance with current fiscal priorities established in the annual budget resolution. One of the many unique features of the reconciliation process is expedited floor procedures.²⁷ Reconciliation has been used in the past to achieve significant deficit reduction.²⁸

Some argue that congressional points of order and expedited procedures may be a safer enforcement mechanism because the levels could be waived by Congress when emergency situations occur and it is advantageous to have the option of breaching statutory levels. However, past enforcement mechanisms, like sequestration, have provided some flexibility for specific economic and domestic situations. For instance, the deficit reduction procedures included in The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings; P.L. 99-177) allowed for suspension in wartime and in the event of a recession. If real economic growth was projected to be negative in two consecutive quarters, or if the Commerce Department reported that actual real growth was below 1% in two consecutive quarters, the deficit level provisions could be suspended. In such an event, Congress could consider a joint resolution under expedited procedures, that once enacted would suspend the deficit reduction provisions for the current fiscal year or for all fiscal years.

Sequestration has existed as an enforcement mechanism in several forms in connection with budget and budget process reform. For instance, it was part of Gramm-Rudman-Hollings in 1985 and continued in some form until 2002 (as described below). Sequestration is currently used to enforce Statutory PAYGO. Within Statutory PAYGO, budgetary effects of new enacted direct spending and revenue provisions are recorded on two separate scorecards. At the end of a congressional session, the scorecards are evaluated to determine if a debit has been recorded for the current budget year; that is, if new legislation has increased or created a deficit. If no such debit is found, no action occurs. If a debit is found, however, the President must issue a sequestration order which automatically implements across-the-board cuts to non-exempt direct spending programs to compensate for the amount of the debit.

Although it has been widely asserted that the mere threat of a sequester forces action, that has been disputed by those who witnessed sequestration under Gramm-Rudman-Hollings. They state that the threat of across-the-board cuts is potentially less politically painful than having to vote on specific spending cuts. Further, many have argued that the threat of sequestration becomes less alarming if more prominent programs are exempt. More information about programs exempt from sequestration is included in the section below.

As seen under previous budget process reforms, projection errors over the span of the year mean that good faith attempts to reach deficit targets can be undermined by events outside

²⁶ Because the regular legislative process can be time consuming and procedurally cumbersome, expedited procedures, also referred to as “fast-track” procedures, are sometimes enacted to allow specific legislation to enjoy special procedures protecting them from many typical obstacles. Since the goal of such procedures is to ensure Congress’s ability to consider the measure, and to do so in a timely manner, Congress is confirming that it deems the specified measure to be of unique importance. For more information on expedited procedures see CRS Report RS20234, *Expedited or “Fast-Track” Legislative Procedures*, by Christopher M. Davis.

²⁷ For more information see CRS Report RL33030, *The Budget Reconciliation Process: House and Senate Procedures*, by Robert Keith and Bill Heniff Jr.

²⁸ CRS Report R40480, *Budget Reconciliation Measures Enacted Into Law: 1980-2010*, by Megan Suzanne Lynch.

congressional control. In particular, only the levels of spending for discretionary programs are determined directly by Congress. Revenue and mandatory spending levels are determined by the interaction between the formulas laid out in statute and the changing circumstances that make individuals liable or eligible, respectively, under that formula. For example, it may be that significant legislation has been enacted to put the country on track to meet the annual deficit target based on certain projections and assumptions used at the time. However, by the end of the year, the original projections may end up being inaccurate, perhaps because the economy did not function as expected, leading to a deficit target that was not reached. In such cases, enforcement could be automatically applied once the projection has been revised, requiring additional actions when the deficit is larger than projected, or enforcement could be applied only to the levels contained in the original budget resolution (based on the original projection), allowing the target to be missed.

Parts of the Budget Subject to an Enforcement Mechanism

If a deficit target applies to the budget as a whole, which includes the components of (1) discretionary spending, (2) mandatory spending, and (3) revenue, will the enforcement mechanism also apply to all components? And will it apply proportionately? Gramm-Rudman-Hollings included general deficit targets that applied to the budget as a whole and were enforced by sequestration, applying formulaic cuts to discretionary and direct spending programs. Controversy arose as many felt that the inability to achieve the deficit targets was caused by changing projections of the impact of revenues or direct spending on the deficit even when action had already been taken to reduce discretionary spending. These criticisms led to the Budget Enforcement Act of 1990 (BEA), which created a “firewall” between discretionary spending and direct spending.²⁹ Caps were set for discretionary spending and were enforced by sequestration solely to discretionary spending programs. PAYGO was established to enforce deficit reductions achieved by changes to revenues and direct spending enacted through reconciliation by limiting the ability of Congress to enact new direct spending and revenue legislation and was enforced by sequestration.

Budget enforcement mechanisms, such as sequestration, frequently focus only on spending and not on revenue. This characteristic of budgetary enforcement has also been criticized as being unattractive. For example, if revenue decreases occur over the course of a year, either due to changes in law or economic factors, some believe it is not fair that spending should absorb the resultant impact on the deficit. Therefore, proposals have been made that a sequester should be accompanied by an automatic revenue surcharge. A mechanism that would apply to all components of the budget, and do so proportionately, would need to be very sophisticated and would likely require alterations over the long term.

Although across-the-board enforcement mechanisms have been criticized for their formulaic and indiscriminate manner of making cuts, they can be tailored to exempt or shield certain programs, making the process more discriminate but greatly reducing the effectiveness as a tool for deficit reduction. For example, under Statutory PAYGO, certain programs and activities are exempt from the PAYGO scorecards, including provisions deemed an emergency by Congress and provisions dealing with four specific “current policy” areas. The four specified areas are Medicare physicians’ payments, the estate and gift tax, the alternative minimum tax (AMT), and extension of certain income tax cuts for the middle class enacted in 2001 and 2003. Without these exemptions, offsets of over \$200 billion could be required in 2011 to finance them.

²⁹ P.L. 101-508.

Additionally, certain programs have been exempt from sequestration itself. Under Statutory PAYGO some direct spending programs and activities are exempt from sequestration, such as Social Security and Tier I Railroad Retirement benefits, federal employee retirement and disability programs, Supplemental Security Income (SSI), Supplemental Nutrition Assistance Program (SNAP), Children's Health Insurance Program (CHIP), Temporary Assistance for Needy Families (TANF), veterans' programs, net interest, refundable income tax credits, Medicaid, and unemployment compensation. In 2010, these exemptions amounted to roughly half of total federal spending. In addition, sequestration, or any enforcement mechanism, can be tailored not only to exempt certain programs, but in some instances to at least shield non-exempt programs. For example, a previous form of sequestration limited reductions in Medicare to 4%.

Switch from Cash-Flow Accounting to Accrual-Basis Accounting

Outlays and revenues are primarily recorded in primary federal budget documents on a cash-flow basis: expenditures are recorded in the fiscal year they are paid out and revenues are recorded in the year they are received.³⁰ For entitlement programs, this means that benefits that have already been promised are not recorded in the budget until the year they are paid out; and there is no record of benefits in the budget in the year they accrue. Critics argue that cash-flow budgeting hides the impact of entitlement programs for the elderly on long-term fiscal solvency (notably, Social Security, Medicare, and parts of Medicaid) since those programs currently have a cash-flow surplus but are projected to face much larger cash-flow deficits in the future.

As discussed above, the primary source of the projected long-term fiscal imbalance is arguably the growth in elderly entitlement spending without a corresponding increase in overall revenues. One method for capturing the effects of future entitlement growth on the current budget would be to switch from cash-flow accounting to accrual-basis accounting. Instead of recording obligations as they are paid out, accrual-based accounting would record the net-present value of obligations as they are incurred.³¹ Under this method, the difference between the present value of newly accrued future benefits and the present value of newly collected receipts (in the case of Social Security and Medicare, payroll taxes) would be recorded as net expenditures.³² New benefit obligations accrue on an annual basis both because newly covered workers enter the entitlement systems and because existing covered workers accrue additional future benefits.

As a comparison, accrual-basis accounting is generally used by private corporations to record future pension and health benefits legally promised to workers. The case for private corporations to use accrual-basis accounting is more clear cut, however, since private corporations cannot generally alter legally guaranteed benefits once they have been contracted. The government, on the other hand, can legislate changes to benefits at any time, and has done so in the past. Accrual-basis accounting requires corporations to hold financial assets to back future benefits that have accrued in order to maintain the solvency of corporate benefit plans. If deficits in corporate plans become too large (when benefits prove to be higher than forecast or asset returns prove to be lower than forecast), accounting rules require that these deficits be made up over a designated period of time by the corporation increasing the assets backing the plans. By contrast, a shift to

³⁰ The primary exceptions are federal loans and loan guarantees that are subject to the Federal Credit Reform Act. The estimated subsidy from these programs is recorded as an outlay in the year the loan or guarantee is made on a net present value basis.

³¹ Net present value allows data to be compared over time by reducing future year data by a discount rate. Under this method, values further into the future get discounted more.

³² Presumably, under accrual-basis accounting, the budgetary totals would reflect net expenditures, since Medicare expenditures are currently included in budgetary totals net of premiums. Alternatively, gross expenditures and gross revenues could be included in budgetary totals.

accrual-basis accounting in the federal budget may—but need not—be accompanied by a requirement that the government begin to hold assets to back accrued future benefits. Therefore, a shift to accrual-basis budgeting alone, without any other changes to entitlement programs, would not change the government’s current or future fiscal imbalance. Alternatively, the government could choose to begin to require that assets be held to back future benefits without adopting accrual-basis budgeting.

Proponents of accrual-basis accounting would argue that it would make the fiscal imbalance more visible and may increase political pressure to address the imbalance. In particular, a shift to accrual-basis budgeting would shift the existing imbalance within entitlement programs for the elderly (between future promised benefits and future dedicated revenue from payroll taxes) from the future to the present budget. The shortfall between the income and expenditures of current and past participants in Social Security is \$17.5 trillion in present value terms, according to the Social Security trustees. For Medicare Part A, the shortfall is \$6.9 trillion in present value terms. For Medicare Part B, the shortfall is \$10.6 trillion in present value terms, which under current law would be made up through general revenues.

There are a number of drawbacks to a shift to accrual-basis accounting. First, from an economic perspective, cash-basis accounting arguably best reflects the effect of the current budget deficit on the current economy because it most closely matches the actual funds that the government must borrow at any given time. By contrast, under accrual-basis budgeting, the federal debt (excluding the intergovernmental debt) would no longer match the actual liabilities of the federal government held by the public, and the budget deficit would no longer match the incremental increase in that debt. This result may also reduce the transparency of the overall budget, even as it increases the transparency of the imbalance in future entitlements. Second, accrual-basis accounting is potentially more subject to manipulation because net expenditures depend heavily on what assumptions are made about demographic factors, such as life expectancy; discount rates; economic factors, such as the growth in future covered wages; and future rates of return on assets held (if any) to back future benefits. All of these factors are subject to uncertainty, yet if more favorable assumptions in any of these areas are used, it would make the current budget balance more favorable.

An argument could be made that accrual-basis budgeting is unnecessary because the long-term fiscal imbalance is already well known, much debated, and captured in other official measures, such as the long-term budget projections prepared by CBO and OMB described above. In addition, accrual-based estimates are already available in the *Financial Report of the United States Government*, although it does not formally incorporate elderly entitlement programs as liabilities on the government balance sheet.³³ As discussed, these long-term budget projections do not play a formal role in the congressional budget process and are not used in current enforcement mechanisms, however.

A switch to accrual-basis accounting raises some technical questions. How would the transition from cash-basis accounting be accomplished? In order to make comparisons over time, would historical budgets be revised on an accrual basis? If not, how would future benefits that were accrued in past fiscal years be recorded? To deal with the shortcomings outlined above, would the government present two sets of books, one cash basis and one accrual basis? If so, how would this affect comprehension of budget issues for both policymakers and the public? Would the

³³ Proponents may take as a given that promised benefits in elderly entitlement programs would be recognized as liabilities under an accrual accounting system. But since Treasury’s accrual-based estimates do not currently do so, a switch to accrual accounting may also require a change in government accounting conventions to achieve the desired goal. For more information, see Government Accountability Office, *Understanding Similarities and Differences between Accrual and Cash Deficits*, GAO-07-117SP, December 2006.

government switch to a system that was entirely accrual-basis, or a hybrid system where entitlement programs for the elderly are recorded on an accrual basis and the rest of the budget is calculated on a cash-flow basis? If so, how would this affect transparency?

Increase the Transparency of Budgetary Decisions

Increasing budget transparency does not directly lead to fiscal sustainability. It may, however, provide greater understanding of long-term challenges and greater incentives for Congress and the President to pursue and adhere to specific long-term debt reduction goals. According to this argument, if current budgetary information did not obscure the size and nature of the long-term fiscal imbalance, there would be greater public support for a solution and more public pressure on policymakers to reach a consensus on a solution.

One option is to make existing long-term budget information more prominent or require it to be included in budget presentations. Many of the other long-term budget proposals discussed in this report, including a longer budget or scoring window, prominent debt or deficit targets agreed upon by the President and Congress, and a switch to accrual accounting, would help further transparency in terms of making information more prominent and central to the budget process. On the other hand, certain long-term budgeting concepts such as the fiscal gap and accrual accounting are highly complex, and could decrease transparency in terms of public understanding of the issue.

Another option would be to require the President to address the nation in a public forum, such as an annual address to Congress, detailing the progress toward achieving fiscal targets or other long-term goals. Such an address could also lay out plans for how to continue to achieve these goals over the next several fiscal years.

Currently budget projections made in budget baselines show declining deficits over the budget window. Many budget analysts agree that these projections give the misleading impression that there is not a long-term fiscal imbalance for two reasons. First, the gradual nature of the projected growth in elderly entitlement spending leads to small increases over short periods but significant increases over long periods. Second, it is argued that the baseline leads to deficit projections that are downward biased due to the way that it is calculated, as assumptions typically yield higher revenue estimates and slower growth of discretionary spending relative to current policy.

Both OMB and CBO compute baseline projections using assumptions set out in budget enforcement legislation, and this legislation requires baselines to follow current law (as opposed to current policy).³⁴ The legislative and macroeconomic assumptions used can greatly affect baseline estimates and projections. Specifically, CBO assumes that discretionary spending remains constant in inflation-adjusted terms, that the 2001 and 2003 tax cuts fully expire after 2010 (as current law specifies), and that one-year “patches” to the AMT will lapse. Depending on when military supplemental bills are enacted, the baseline can also sometimes partially omit those costs (because it only incorporates enacted legislation, not legislation that is likely to be enacted).³⁵ If the baseline concept is well understood, then these assumptions are not misleading. If the public or policymakers interpret the baseline to be a “best guess” of future outcomes, however, then the baseline would arguably give a misleadingly rosy outlook of the fiscal situation. To make the budget more transparent, Congress could consider revising the statutory

³⁴ Both OMB and CBO generally follow the rules set forth in Section 257 of the Deficit Control Act of 1985. Although some budget enforcement legislation constraining the computation of baseline estimates has expired, CBO has indicated that it will follow these practices until directed otherwise by Congress.

³⁵ The OMB current services baseline arguably addresses some of these concerns.

assumptions required to calculate the baseline in order to gain a more realistic picture of the budget deficit.

An alternative perspective is that greater transparency is not needed because the long-term fiscal imbalance is already well known and understood by policymakers and the public. As this report has outlined, official government sources already release several detailed estimates of the long-term fiscal imbalance, the President's Fiscal Commission and several independent organizations are working on detailed proposals to rectify the imbalance, and many policymakers have highlighted the issue in various forums. In this view, the problem is not a lack of understanding but a lack of consensus as to how best solve the problem. Postponing a decision may be preferable to those directly affected since sacrifices, in the form of higher taxes or lower spending necessary to solve the problem, are likely to seem painful.

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